7/24/81

B 5350-2

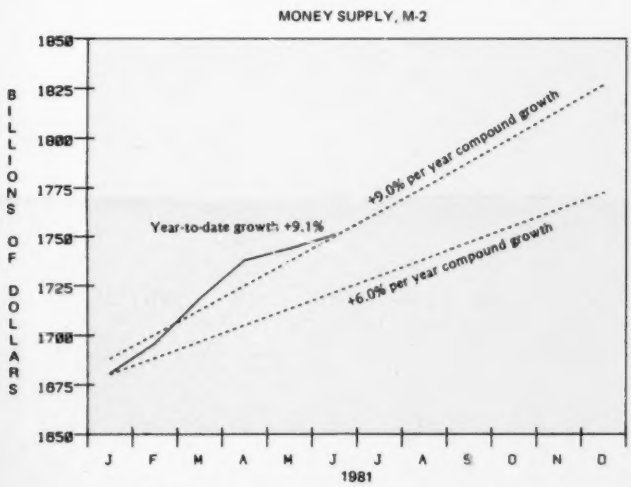
The Manufacturers Hanover
Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

MONDAY, JULY 20, 1981 VOLUME XVIII, NUMBER 29

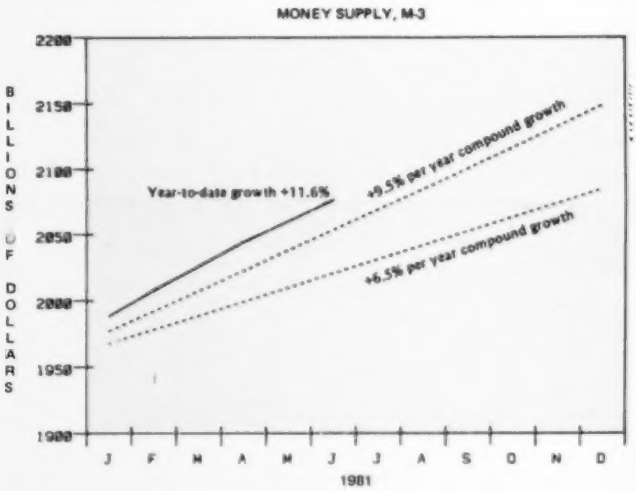
The Pull Of Demand-Side Factors . . .

Despite widespread expectations to the contrary, interest rates have remained high, both in the short- and long-term markets. Although such fundamentals as the pace of economic activity and the rate of inflation still point to some declines later this summer, other signs are ambiguous, thus delaying the onset of sustained money and bond market rallies.

On the supply-side, the Federal Reserve continues to maintain a firm grip on the monetary reins. This posture is unlikely to be altered significantly until all the monetary aggregates return to their 1981 growth target boundaries. As a result, any interest rate declines will have to come from reduced demand, rather than increased supplies of funds from the Federal Reserve. What is more, when they do arrive, such declines are likely to occur in fits and starts, reflecting changes in the momentum of the economy, the inflation rate statistics and Treasury and corporate borrowing requirements.



In the economy, the signals continue to indicate that the growth momentum so much in evidence in the first quarter ceased in the second—if it did not actually turn negative. Among the more recent indicators of the slump into which the economy has



fallen is the 1.8 per cent drop in the index of leading economic indicators in May, the continuing sluggish pace of new automobile sales, which ran at less than a 5.6 million-unit annual rate in the second quarter, almost 25 per cent below first quarter levels, the weak pace of new housing starts, which fell to a 1.15 million-unit rate in May, compared with the almost 1.4 million-unit average which prevailed in the first quarter, and a sharp deterioration in U.S. export prospects abroad, as reflected in four consecutive monthly declines in new export orders for manufacturers' durable goods.

But while the renewed downturn in the housing and auto industries may ensure that the "real" economy exhibits little or no growth in the spring and summer quarters, the decline may not be steep enough to reduce the demand for funds from the private sector. Retail sales growth, for example, turned positive again in June following two consecutive monthly declines, while factory orders and personal incomes continue to expand. What is more, such sectors as defense, energy and high technology—not to mention mergers and acquisitions—continue to require more money and credit. Finally, the current pause may be short-lived, if substantial personal and business tax cuts are enacted soon.

Copyright 1981
Manufacturers Hanover Trust Company
350 Park Avenue, New York, NY 10022

BEST AVAILABLE COPY

. . . May Prompt Lower Interest Rates . . .

Perhaps the brightest economic news to emerge this year has been the slowing in the rate of inflation. A marked easing of food and energy price pressures has pushed the rate of inflation into single-digit territory. And although it now appears that a renewed upturn in food prices may offset some of the drop in energy costs, it remains unlikely that the rate of inflation will move back into double-digit annual rates for a sustained period any time soon.

This drop in the rate of inflation has not been matched by similar declines in rates of interest. In fact, just the opposite has occurred, with differentials between rates of inflation and interest rising to historic highs in both the money and credit markets (Financial Digest—May 11, 1981). Clearly, for this to occur, financial market participants—and especially buyers of long-term, fixed income debt obligations—must remain largely unconvinced that the recent abatement of inflationary pressures is permanent. As a result, inflation expectations among investors now far exceed the actual rate of inflation, and until such time as expectations move into better alignment with the price statistics, there is little reason to expect interest rates to drop.

If investors remain skittish about locking up the

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 7/8/81	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	131.014	+ .883	+ .329
Loans to Depository Inst.	1.868	+ .133	+ 1.652
Float	3.045	– .287	– 2.619
Total Reserve Bank Credit	146.653	+ .478	+ 4.392
Treasury Deposits with Federal Reserve Banks	2.934	– .279	– .168
Currency Outside Banks	124.308	+ 1.321	+ 7.498
Member Bank Reserves:			
Required	40.017	– .813	– 2.539
Excess (Deficiency)	.572	+ .084	+ .070
Total Reserves Held	40.589	– .729	– 2.469
Net Borrowed Reserves	1.054	+ .113	+ 1.346
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	96.370	– 1.104	+14.103
		% Change Since Three Months Ago*	% Change Since Year Ago
Monetary Aggregates †			
M-1A	364.8	– 3.9‡	– 2.6‡
M-1B	434.2	+ 1.9‡	+ 9.6‡
M-2 (June '81)	1,750.7	+ 7.5	+ 10.2
L (March '81)	2,442.3	+ 10.9	+ 10.5

†Seasonally adjusted. *Seasonally adjusted annual rate. ‡Four-week moving average.

New York Money Market

Offering Rates 7/17/81	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	14.45%	14.34%	13.57%
* Federal Agencies	15.75	15.70	14.93
* Project Notes—Taxfree (46% Taxable Equivalent)	13.52	13.89	NA
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	17.50	17.13	16.50

‡Finance Company Paper—Prime

5- 14 days	17.25%
15- 29 days	17.25
30- 59 days	17.00
60- 89 days	16.00
90-179 days	15.00
180-239 days	14.63
240-270 days	13.00

‡* Bankers' Acceptances

Aug.	17.25%
Sep.	17.00
Oct.	16.70
Nov.	16.40
Dec.	16.00
Jan.	15.80

‡Industrial Paper—Prime

30- 89 days	17.13%
90-120 days	16.75

†Federal Funds Effective Rate 17.85%

‡Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	1st Q'81	$ 2,853	$ 2,731	$ 2,572
Gross National Product (1972 Dollars)*	1st Q'81	$ 1,516	$ 1,486	$ 1,502
Percent Change, Annual Rate	1st Q'81	8.6%	3.8%	3.1%
Change in Consumer Prices (all urban consumers)*	May '81	8.4%	4.8%	10.8%
Change in Producer Prices*	Jun '81	7.2%	4.8%	9.6%
Civilian Employment (Thousands of Persons)†	Jun '81	98,392	99,235	96,780
Unemployment as % of Civilian Labor Force†	Jun '81	7.3%	7.6%	7.5%
Personal Income*	May '81	$ 2,367	$ 2,354	$ 2,114
Leading Indicators Composite Index (1967=100)†	May '81	135.2	137.7	123.0
Industrial Production Index (1967=100)†	Jun '81n	152.7	152.8	141.5
Net Change in Consumer Installment Credit†	May '81	$ 1.35	$ 2.33	–$ 2.68
U.S. Merchandise Trade Balance†	May '81	–$ 2.44	–$ 2.47	–$ 2.94
Plant and Equipment Expenditures*	3rd Q'81	$322.88(a)	$317.29(a)	$296.23
Private Housing Starts (Thousands of Units)*	Jun '81n	1,032	1,159	1,184
New Construction Expenditures*	May '81	$ 237.3	$ 248.9	$ 218.9
Total Business Inventories†	May '81n	$ 477.8	$ 474.6	$ 450.3
Total Business Sales†	May '81n	$ 344.2	$ 345.7	$ 298.0

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. a-Anticipated.

BEST AVAILABLE COPY

high yields now prevailing in the credit markets, borrowers, in contrast, appear undeterred by prevailing high interest rates. Despite high real borrowing costs—as well as rising household and business bankruptcies—credit demands remain strong in many sectors of the economy. The rapid growth of short-term business credit demands, whether to finance either intended or unintended inventory accumulation or mergers and acquisitions, has also been a principal factor in propping up short-term interest rates in recent weeks.

With loan portfolios ballooning but with the Federal Reserve supplying reserves to the banking system only very sparingly, banks have had to step up their purchases of funds in the money markets, putting upward pressures on all reserve-related interest rates. Besides the overall demand for funds, the length of time for which the funds are being borrowed has also kept interest rates high. In what is emerging as something of a Catch-22 situation, the banks are purchasing only short-term money, in the expectation of an imminent drop in interest rates. Yet, because the Fed is attempting to control only the supply of money and not its price, it is making no effort to offset the high interest rates that have resulted from this concentration of borrowing. Nor does much relief appear likely soon. Loan commit-

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Negotiable Time CD's Weekly Reporting Banks			
Nationwide (7/1/81)	122,706	+ 1,480	+30,825
New York City (7/1/81)	29,827	+ 996	+ 7,983
Commercial Paper (7/1/81)	149,050	+ 427	+23,929

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (7/1/81)	182,409	+ 3,659	+22,557
New York City (7/1/81)	53,556	+ 1,562	+ 6,127

Total Loans Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (7/1/81)	450,104	+10,351	+52,588
New York City (7/1/81)	109,715	+ 5,463	+19,275

Financial Markets

	Friday 7/17/81	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	15.09%	– .52	+ 7.08
180-Day Bills†	15.53	+ .23	+ 7.36
Longest Bills†	15.29	+ .44	+ 6.99
Recent Issues:			
14⅝s 6/30/83	15.01	+ .39	
14s 6/30/85	14.62	– .23	
14¼s 5/15/91	14.06	+ .26	
13⅞s 5/15/11	13.38	+ .06	
Municipals:			
Bond Buyer–20 Bond Index* (7/16/81)	11.09%	+ .12	+ 3.06
Blue List Total ($ Million)	$ 951	– $ 20	– $ 2
30-Day Visible Supply ($ Million)	$1,665	– $341	– $ 733
Total	$2,616	– $361	– $ 735
Corporates:			
Moody's Aa Composite (7/16/81)	14.69%	+ .01	+ 3.26
Money Mgr.–30-Day Supply ($ Million)	$7,998	– $ 6	+ $4,462
Stocks:			
Dow-Jones Averages:			
Industrials	958.90	+ 3.23	+ 34.92
Transportation	411.40	+ 7.64	+ 101.80
Utilities	108.39	+ .75	– 5.89
65 Stocks	373.73	+ 3.29	+ 36.44
Standard and Poor's 500 Stocks	130.76	+ 1.38	+ 8.72
N.Y.S.E. Composite Index	75.96	+ .81	+ 6.12
N.Y.S.E. Avg. Daily Vol. for Week (000's)	42,854	– 3,140	– 9,750

* 46% Taxable equivalent 20.54%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 7/17/81	Week Ago
Overnight	18.38%	19.50%
1 month	18.50	19.00
3 month	18.56	18.50
6 month	18.25	18.00
1 year	17.00	16.88

EURODOLLAR BONDS Average Yield		
Medium Term (5 to 7 yrs.)	14.80%	14.75%
Long Term (7 to 15 yrs.)	14.70	14.75

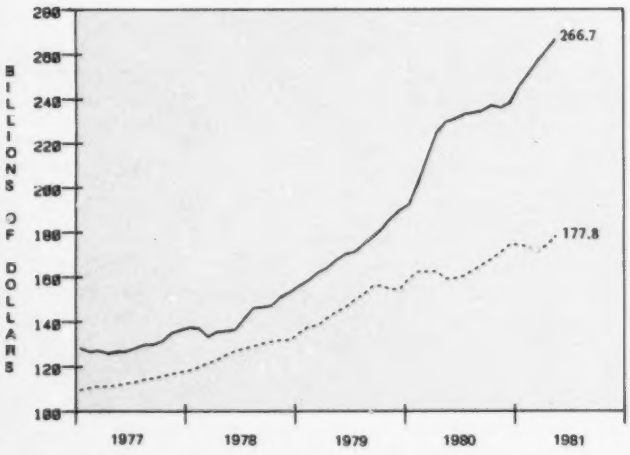
FOREIGN EXCHANGE SPOT RATES New York Opening (7/17/81)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.02517	39.735
Canada	.8295	1.2055
Denmark	.1316	7.5993
France	.1737	5.7560
Germany	.4120	2.4270
Italy	.0008271	1209.00
Japan	.004316	231.70
Mexico	.04070	24.57
Netherlands	.3700	2.7030
Switzerland	.4794	2.0858
U.K.	1.8770	.5328

ments to commercial and industrial firms have increased even more rapidly than loans outstanding during the year ending May 31 (see following chart), suggesting that loan demand at commercial banks might remain strong for some time to come.

. . . But Not The Federal Reserve

As for the Federal Reserve, it is unlikely to execute an abrupt and unambiguous policy shift, at least in the near term. The upturn in the growth of non-borrowed reserves during the past month appears to be technical, not indicative of a relaxation of policy.

TOTAL LOAN COMMITMENTS (LINE) VS. OUTSTANDING C & I LOANS (DOT)



Indeed, no substantive change can be expected until all the monetary aggregates have returned to their respective 1981 growth target bands. Thus, the fact that M-1B is expanding at a seasonally adjusted annual rate well below its six per cent lower target boundary, should not be interpreted as a harbinger of an imminent relaxation of Fed policy, since the year-to-date growth of the broader monetary aggregates M-2 and M-3 is still above their upper target boundaries, as the charts on the front page indicate.

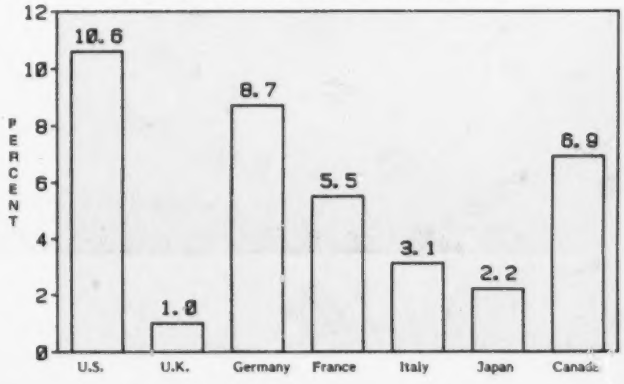
U.S. Interest Rates Slow Growth Abroad

Interest rates are also a major item on the agenda at the economic summit meeting in Ottawa this week. Although high U.S. interest rates have both internal and external impacts on the other industrial nations, it is the internal effects that are currently generating the greatest concern—particularly on employment and growth. The emphasis on internal effects is due to escalating unemployment which, according to the OECD, will rise in the other six countries attending the Ottawa meeting from 5.7 per cent in 1980 to close to seven per cent in 1981—high for these countries. The jump in unemployment is an important problem in each of these countries. France, for example, with an unemployment rate of 7.5 per cent and a new government committed to increasing job opportunities as well as the United Kingdom with an unemployment rate currently running at over ten per cent are particularly sensitive to this increase.

High real interest rates in the United States have had the effect of draining investment funds out of those economies where domestic interest rates are lower and into the U.S. or the Eurodollar market. This, in turn, has either increased domestic interest rates to business borrowers as rates have been raised competitively (see chart) or, where interest rates and the money supply are limited, credit has dried up. As a consequence, business borrowing has been discouraged, restricting economic growth and employment opportunities.

In an environment of sluggish growth or recession, rising unemployment, high inflation and slowing world trade, high borrowing costs for business add another onerous burden. The real cost of borrowing although lower in most cases than in the United States is superimposed on smaller, less flexible economies which do not display the signs of vigor still evident in some sectors of the U.S. economy. Further, many of the countries attending the conference, such as Japan, France and Italy have new governments committed to rapid economic resurgence and eager to begin this task. Others, such as Germany and the United Kingdom are facing internal political and economic problems that challenge the present incumbents.

REAL INTEREST RATES TO BORROWERS (PRIME RATE LESS 12-MONTH PRICE CHANGE)



With the high probability that monetary policy in the U.S. will not ease rapidly, relatively high interest rates are likely to continue through year-end 1981, at least, continuing to attract funds from abroad. This will delay any recovery in other countries, whose governments would like to lower interest rates to stimulate their economies without further weakening their currencies. Even when U.S. interest rates do decline, however, they are likely to remain above other countries' rates, since foreign governments may allow their own rates to fall in step with ours to encourage economic activity. ■